

Message Text

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44

ACTION EUR-25

INFO OCT-01 ISO-00 EURE-00 AID-20 CIAE-00 COME-00 EB-11

FRB-03 INR-11 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12

SP-03 CIEP-03 LAB-06 SIL-01 OMB-01 NSC-07 SS-20

STR-08 CEA-02 L-03 H-03 PA-04 PRS-01 USIA-15 DRC-01

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FM AMEMBASSY COPENHAGEN

TO SECSTATE WASHDC PRIORITY 1584

INFO AMEMBASSY BONN

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USMISSION EC BRUSSELS

AMEMBASSY DUBLIN

AMEMBASSY THE HAGUE

AMEMBASSY LONDON

AMEMBASSY LUXEMBOURG

USMISSION NATO

AMEMBASSY OSLO

S/AMEMBASSY PARIS PRIORITY 2069

USMISSION OECD PARIS

AMEMBASSY ROME

AMEMBASSY STOCKHOLM

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DEPARTMENT PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: N/A

TAGS: EGEN, EFIN, DA

SUBJECT: INCOMES POLICY VERSUS KRONER DEVALUATION

REF: COPENHAGEN 1852

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BEGIN SUMMARY: POSSIBILITY OF KRONER DEVALUATION

HAS AGAIN ENTERED PUBLIC DEBATE IN DENMARK. MOST OF DISCUSSION IS LONG RANGE, CITING DEVALUATION AS ONE OF SEVERAL POSSIBLE ECONOMIC TOOLS WHICH SHOULD BE CONSIDERED IN LIGHT OF PRESENT ECONOMIC DIFFICULTIES. LEAKING TO PRESS OF CONFIDENTIAL PAPER BY COUNCIL OF ECONOMIC ADVISERS HAS GIVEN FURTHER FUEL TO DEBATE BUT, ACCORDING TO CEA OFFICIAL, ITS COMMENTS ON DEVALUATION WERE TAKEN OUT OF CONTEXT FOR CEA WAS NOT RECOMMENDING DEVALUATION, MERELY ANALYSING ITS POSSIBLE EFFECTS. GOVERNMENT AND CENTRAL BANK OFFICIALS CONTINUE TO TELL US THAT THEY WILL UNDER NO CIRCUMSTANCES RECOMMEND DEVALUATION. THEY SEE DEVALUATION POSSIBLE ONLY IF DENMARK IS AGAINST THE WALL. WHILE ECONOMIC PROBLEMS ARE SERIOUS, NO SUCH EMERGENCY CONDITIONS ARE FORESEEN AT PRESENT. END SUMMARY.

1. IN CONNECTION WITH ONGOING POLITICAL DEBATE OVER GOVERNMENT'S FISCAL REFORM PROGRAM (REPORTED SEPTEL), INCOMES POLICY HAS BEEN BROUGHT INTO THE PICTURE EITHER AS PREREQUISITE FOR REFORM OR AS PART OF OVERALL PACKAGE. LABOR REACTION HAS GENERALLY BEEN NEGATIVE AND IT IS CLEAR THAT PROPONENTS OF AN EFFECTIVE WAGE RESTRAINT PROGRAM HAVE A STIFF UPHILL FIGHT. RECENTLY, MEDIA HAS PUBLICIZED COMMENTS BY SEVERAL ECONOMISTS SUGGESTING DEVALUATION OF KRONER AS ALTERNATIVE TO INCOMES POLICY; THESE WERE GIVEN PASSING ATTENTION. HOWEVER, LEAKING TO PRESS OF CONFIDENTIAL PAPER BY COUNCIL OF ECONOMIC ADVISERS (CEA), PREPARED FOR PLENARY SESSION OF COUNCIL SEPTEMBER 10, BROUGHT DEVALUATION ISSUE INTO HEADLINES ON SEPTEMBER 6.

2. EMBOFF DISCUSSED PRESS REPORTS WITH CEA CHIEF ECONOMIST WHO SAID THEY WERE OVER-SIMPLIFICATION AND, IN SEVERAL POINTS, MISINTERPRETATION OF CEA PAPER. WHILE CEA STATUTES PROHIBIT RELEASE OF PAPER TO OTHER THAN COUNCIL MEMBERS UNTIL LIMITED OFFICIAL USE

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AFTER PLENARY SESSION, CEA OFFICIAL AGREED TO BRIEF US ORALLY ON PARTS OF PAPER RELATED TO DEVALUATION. IN SUMMARY, CEA ANALYSIS GOES AS FOLLOWS: IN PRESENT DANISH ECONOMIC SITUATION, WITH SEVERE BALANCE OF PAYMENTS DEFICIT AND HIGH RATE OF INFLATION, COUNCIL FELT OBLIGED TO INCLUDE, IN ITS OVERALL REVIEW, TECHNICAL ASPECTS OF EXCHANGE RATE ADJUSTMENT, ALTHOUGH

COUNCIL FULLY REALIZES POSSIBLE NEGATIVE EFFECTS OF BRINING DEVALUATION ISSUE INTO PROMINENCE O OF PUBLIC DEBATE. ACCORDING TO CEA OFFICIAL, PAPER MERELY COMPARED EFFECTS OF INCOMES RESTRAINT WITH DEVALUATION, SPECIFICALLY THE EFFECT OF A 10 PERCENT WAGE REDUCTION VERSUS A 20 PERCENT DEVALUATION.

3. CEA PAPER ALSO NOTED THAT PRESENT SITUATION WITH HIGH PAYMENTS DEFICIT, COST RISES AND, SIMULTANEOUSLY, RISING UNEMPLOYMENT MADE EFFECTIVE MEASURES EVEN MORE NECESSARY THAN BEFORE AND, BECAUSE ECONOMY IS NOW WORKING AT LESS THAN FULL CAPACITY, PROVIDED BASIS FOR POSSIBLE APPLICATION OF DEVALUATION TOOL. CEA OFFICIAL STRESSED, HOWEVER, THAT PAPER STRONGLY UNDERLINED THAT DEVALUATION WOULD BE USELESS WITHOUT CONCOMITANT APPLICATION OF EFFECTIVE INCOMES POLICY AND EMPHASIZED THAT DEVALUATION WOULD GIVE ANOTHER SPURT TO INFLATION RATE. CEA OFFICIAL INSISTED THAT CEA PAPER DID NOT RECOMMEND DEVALUATION BUT PRINCIPALLY FOCUSSED ON NECESSITY OF REDUCING DOMESTIC COST LEVELS TO FEND OFF OTHERWISE UNAVOIDABLE UNEMPLOYMENT RISE IN REMAINDER OF THIS YEAR AND NEXT.

4. EMBASSY COMMENT: IT IS OUR IMPRESSION THAT COUNCIL POSITION ON KRONER DEVALUATION IS GENERALLY IN LINE WITH THAT OF GOVERNMENT AND CENTRAL BANK AUTHORITIES. THESE LATTER HAVE TOLD EMBOFFS RECENTLY THAT, WHILE PRESENT REDUCED LEVEL OF ECONOMIC ACTIVITY HAS RELEASED SOME CAPACITY LIMITED OFFICIAL USE

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AND MADE DEVALUATION LESS SONESELESS AS AN ECONOMIC TOOL, OVERALL NEGATIVE ASPECTS WERE STILL DOMINANT. ONE OFFICIAL SAID FLATLY THAT A DECISION FOR DEVALUATION COULD ONLY BE MADE OVER THE PROSTRATE BODIES OF DANISH CIVIL SERVANTS OR, ALTERNATIVELY, IN SITUATION WHERE EXCHANGE RESERVE DEVELOPMENTS PUT DENMARK AGAINST THE WALL. WHILE NOT EXCLUDING LATTER POSSIBILITY, HE SAW NOTHING IN CURRENT DEVELOPMENTS THREATENING AN EMERGENCY; NEITHER DO WE.
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